Morningstar Corporate Credit Research Highlights

High-Yield Credit Spread Rivals Tightest Levels Since Before Global Financial Crisis

Morningstar Credit Ratings, LLC

24 September 2018

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Credit Rating Actions

- Rating Changes

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Kansas City Southern **KSU**	BBB+	BBB[1]

(1) Correction notification: Please note that the earlier version of our Credit Highlights incorrectly displayed the Previous Issuer Credit Rating for Kansas City Southern. This version corrects that error.

- Rating Affirmations

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Beckton, Dickinson **BDX**	BBB	BBB
Netflix **NFLX**	BB-	BB-
Norfolk Southern **NSC**	BBB+	BBB+
Canadian National Railway **CNR**	A	A
Canadian Pacific Railway **CP**	BBB+	BBB+
JPMorgan Chase **JPM**	A	A
CSX **CSX**	BBB+	BBB+
U.S. Bancorp **USB**	AA-	AA-

Recent Notes Published by Credit Analysts

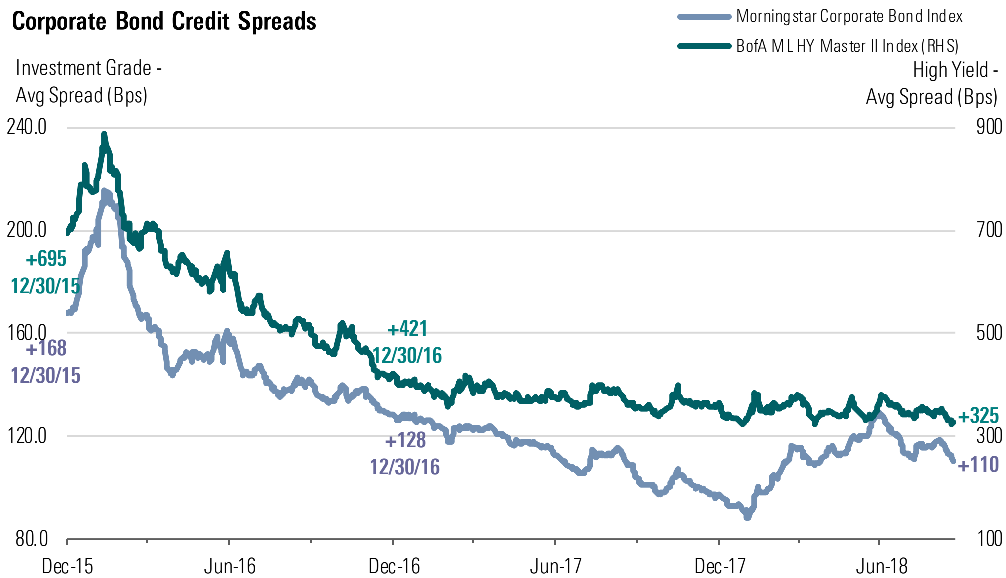
- **BP** (A-, Stable) Issues Debt for General Corporate Purposes and Working Capital
- **Interpublic Group** (BBB, Stable) Announces New Senior Notes to Fund Acxiom Acquisition
- U.K. Regulators Plan Auction to Resolve Competition Between **Comcast** (BBB+, Negative) and Fox for Sky
- **Adobe Systems** (AA-, Stable) Acquiring Marketo for $4.75 Billion; Credit Rating Unaffected

Credit Market Insights

High-Yield Credit Spread Rivals Tightest Levels Since Before Global Financial Crisis

The ongoing trade spat with China has not been able to derail investor enthusiasm for risk assets, and corporate credit spreads continued to tighten last week. The average spread of the Morningstar Corporate Bond Index (our proxy for the investment-grade market) tightened 3 basis points to end the week at +110. In the high-yield market, the BofA Merrill Lynch High Yield Master Index tightened 4 basis points to end the week at +325. Across other asset markets, equities continued their upward march as the S&P 500 rose 0.85% to a new high, oil prices surged almost $2 per barrel to $70.72, and copper spiked $0.23 per pound to $2.85.

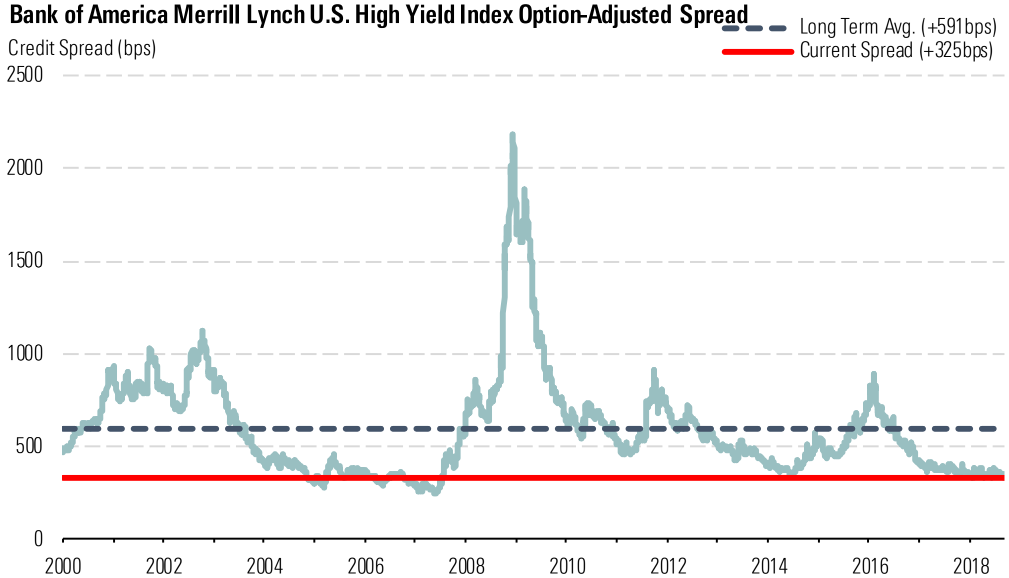
Corporate Bond Credit Spreads



Source: Morningstar,Inc., BofA Merrill Lynch Global Indexes. Data as of 9/21/2018.

The high-yield market has historically had a closer correlation to movements in the equity market than the investment-grade market, which has had a closer correlation to movements in interest rates, and this time is no different. As the equity market has continued its ascent to new highs, the average spread of the high-yield market has reached its tightest levels of the year, as well as the tightest that it has traded at since before the 2008-09 global financial crisis. Year to date, the average spread in the high-yield market has tightened 38 basis points.

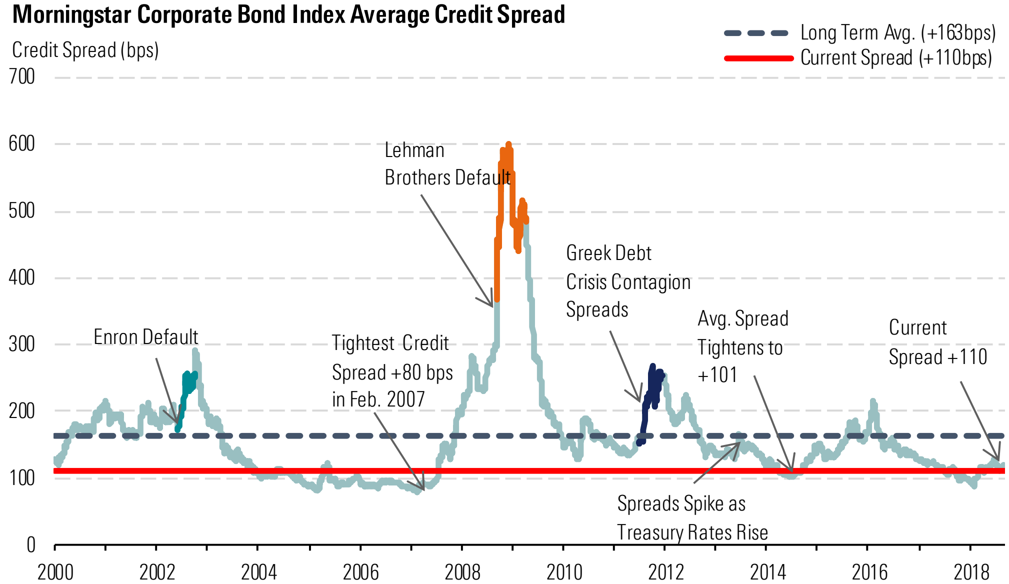
Bank of America Merrill Lynch U.S. High Yield Index Option-Adjusted Spread



Source: Bank of America Merrill Lynch Global Indexes, Data as of 9/21/2018.

However, after hitting its tightest levels since the 2008-09 global financial crisis earlier this year, the average credit spread in the investment-grade market backed up as interest rates surged higher across the entire yield curve. While the high-yield market has tightened this year, the average spread in the investment-grade market has widened 13 basis points. Between rising interest rates and wider credit spreads, investment-grade bonds have lost money for investors this year. The year-to-date return for the Morningstar Corporate Bond Index is negative 2.36%. With its shorter duration, the high-yield market is not affected as much by rising interest rates, and with high-yield spreads tightening, the high-yield index has risen 2.34%.

Morningstar Corporate Bond Index Average Credit Spread



Source: Morningstar, Inc. Data as of 09/21/2018.

As investors chased risk asset prices higher, bond prices in the U.S. Treasury market weakened, pushing yields up to their highest levels in years. The yield on the 2-year Treasury rose 2 basis points to 2.80% last week and has risen a total of 92 basis points this year. At its current rate, the yield on the 2-year is at its highest yield since mid-2008. The 5-year Treasury yield rose 5 basis points to 2.95%, also its highest since mid-2008, and is now closing in on the 3% psychological ceiling that the 10-year bond finally broke though. The yield on the 10-year Treasury rose 6 basis points last week to 3.06% and has risen 65 basis points thus far this year. The last time the 10-year traded sustainably above 3% was in mid-2011. At the longest end of the yield curve, the 30-year Treasury rose 7 basis points to 3.20% and has risen 46 basis points this year.

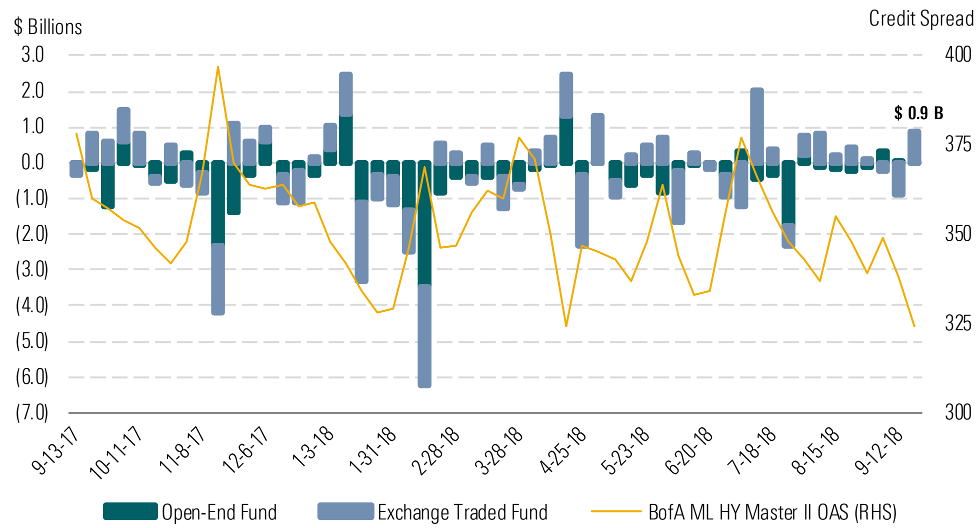
The Federal Open Market Committee meets this week and based on the current market-implied probabilities for additional hikes to the federal-funds rate, it appears that the market believes it is a foregone conclusion that the Federal Reserve will hike the federal-funds rate another 25 basis points to 2.00%-2.25% from its current 1.75%-2.00%. Following this hike, according to the CME FedWatch Tool, the market is pricing in an 86% probability of an additional hike following the December FOMC meeting to over 2.25%. According to market pricing, the Fed will have at least one more rate hike in store for 2019 and possibly two. The futures market is pricing in an 81% probability that the fed-funds rate will end 2019 at 2.50% or higher and a 46% probability it will be 2.75% or higher.

For greater detail regarding our credit ratings as well as for access to our corporate credit research and notes, please visit www.morningstarcreditratings.com.

Weekly High-Yield Fund Flows

Net fund inflows into the high-yield asset class last week reversed the outflows of the prior week. The total amount of inflows was $0.9 billion, consisting almost entirely of net new unit creation among high-yield exchange-traded funds as the amount of inflows among high-yield open-end mutual funds was essentially zero. Typically, fund flows among exchange-traded funds have been considered to be indicative of institutional investor demand, whereas fund flows in open-end high-yield funds are representative of individual investor demand. Year to date, fund flows have registered a total outflow of $14.8 billion, consisting of $2.5 billion of net unit redemptions across ETFs and $12.3 billion of redemptions among open-end funds.

Estimated Weekly High-Yield Bond Fund Flows and High Yield Credit Spreads



Source: Morningstar, Inc. and BofA Merrill Lynch Global Indexes.

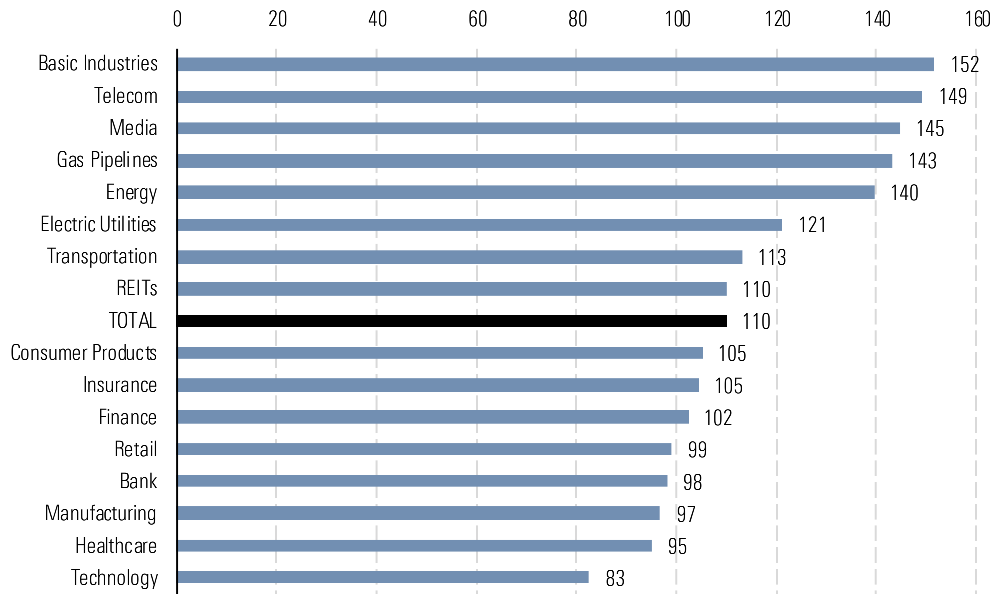
Exhibit 1 Morningstar Corporate Bond Index Sector Summary

Sector	Average Rating	Number of Issues	Modified Duration	Spread (bps)	MTD Spread Chg (bps)	YTD Spread Chg (bps)	MTD Total Return (%)	YTD Total Return (%)
TOTAL	**A-**	**5,101**	**6.8**	**110**	**(7)**	**14**	**(0.41)**	**(2.36)**
FINANCIAL	**A-**	**1,476**	**5.3**	**100**	**(6)**	**17**	**(0.40)**	**(1.85)**
Bank	A-	900	4.7	98	(6)	17	(0.28)	(1.58)
Finance	A	261	5.6	102	(7)	15	(0.50)	(2.20)
Insurance	A	217	8.1	105	(6)	18	(0.89)	(3.13)
REITs	BBB+	89	5.8	110	(3)	6	(0.75)	(1.65)
INDUSTRIAL	**A-**	**2,967**	**7.5**	**114**	**(8)**	**13**	**(0.38)**	**(2.59)**
Basic Industries	BBB	246	7.3	152	(9)	23	(0.39)	(3.19)
Consumer Products	BBB+	354	7.3	105	(6)	21	(0.61)	(3.54)
Energy	A-	397	7.3	140	(9)	18	(0.31)	(2.24)
Healthcare	A-	417	7.7	95	(8)	7	(0.50)	(2.89)
Manufacturing	A-	461	5.9	97	(7)	16	(0.39)	(2.30)
Media	BBB+	166	8.5	145	(10)	15	(0.23)	(2.99)
Retail	A-	171	7.7	99	(9)	12	(0.35)	(2.71)
Technology	A+	351	7.2	83	(9)	5	(0.35)	(2.01)
Telecom	BBB+	167	9.0	149	(15)	6	0.08	(1.62)
Transportation	BBB+	172	8.9	113	(8)	15	(0.46)	(3.51)
UTILITY	**BBB+**	**608**	**8.6**	**131**	**(8)**	**11**	**(0.65)**	**(2.94)**
Electric Utilities	A-	349	9.1	121	(6)	18	(0.97)	(4.04)
Gas Pipelines	BBB	242	7.8	143	(11)	(0)	(0.20)	(1.32)
Rating Bucket								
AAA Bucket		122	7.6	46	(6)	(2)	(0.50)	(2.36)
AA Bucket		501	5.6	61	(5)	2	(0.46)	(1.44)
A Bucket		1,914	6.8	88	(6)	14	(0.55)	(2.59)
BBB Bucket		2,564	7.1	143	(10)	15	(0.28)	(2.36)
Term Bucket								
1-4	A-	1,655	2.3	63	(5)	5	(0.10)	0.37
4-7	A-	1,183	4.7	101	(6)	22	(0.43)	(1.24)
7-10	A-	890	6.9	125	(7)	19	(0.61)	(2.77)
10PLUS	A-	1,373	13.5	161	(12)	16	(0.61)	(5.86)

Data as of 09/21/2018

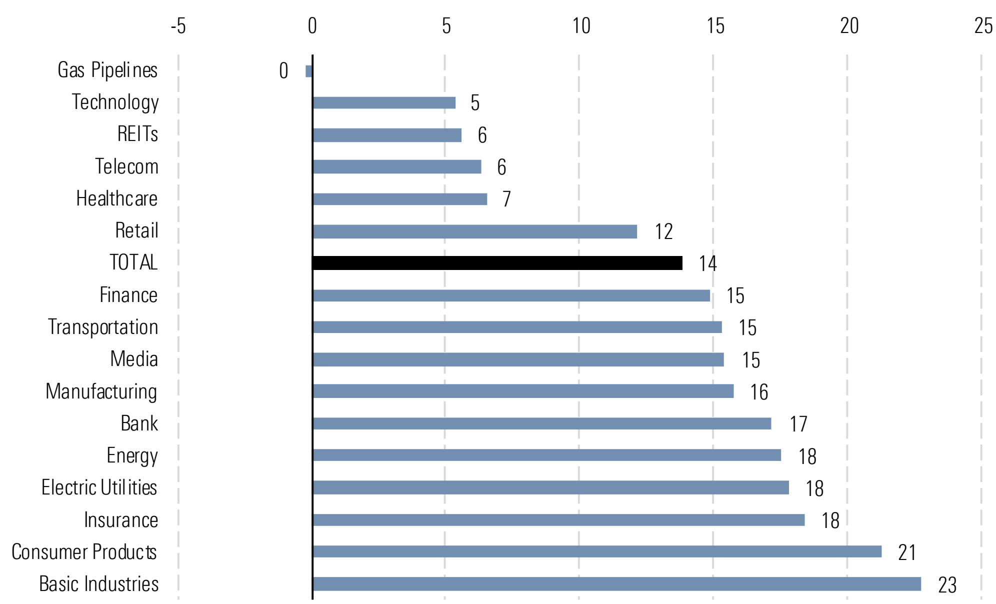
Source: Morningstar, Inc.

Exhibit 2 Morningstar Corporate Bond Index Spread by Sector



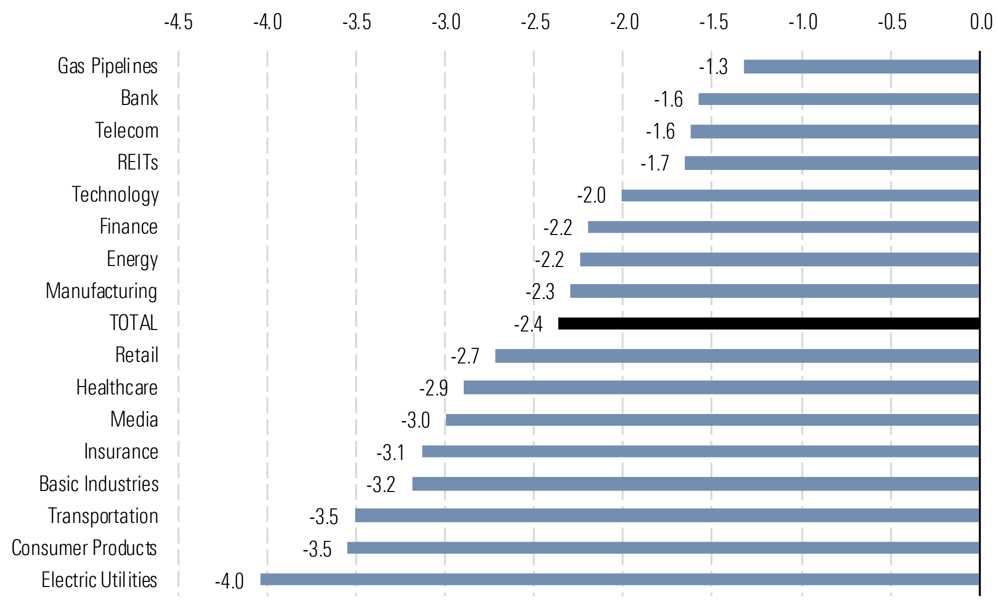
Source: Morningstar, Inc.

Exhibit 3 Morningstar Corporate Bond Index YTD Spread Change



Source: Morningstar, Inc.

Exhibit 4 Morningstar Corporate Bond Index YTD Return



Source: Morningstar, Inc.

Credit Rating Actions

Rating Changes

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Kansas City Southern **KSU**	BBB+	BBB[1]

(1) Correction notification: Please note that the earlier version of our Credit Highlights incorrectly displayed the Previous Issuer Credit Rating for Kansas City Southern. This version corrects that error.

Rating Affirmations

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Beckton, Dickinson **BDX**	BBB	BBB
Netflix **NFLX**	BB-	BB-
Norfolk Southern **NSC**	BBB+	BBB+
Canadian National Railway **CNR**	A	A
Canadian Pacific Railway **CP**	BBB+	BBB+
JPMorgan Chase **JPM**	A	A
CSX **CSX**	BBB+	BBB+
U.S. Bancorp **USB**	AA-	AA-

Morningstar Credit Ratings Releases Updated Ratings for Kansas City Southern

Morningstar Credit Ratings, LLC is upgrading our corporate credit rating on Kansas City Southern one notch to BBB+. Previously, we believed that the rail's smaller revenue base and large Mexican exposure essentially capped its ultimate rating despite credit metrics that were at least consistent with, if not superior to, its higher-rated peers. That said, and despite the political tumult, the rail has bolstered its profitability enough over the last year to further strengthen its credit profile. We now believe that the company's credit profile is sufficient enough to outweigh these risks and are upgrading our rating. We expect that the rail's credit profile will remain similar over the next few years, and we are assigning it a stable outlook.

Our BBB+ rating reflects Kansas City Southern's competitive position and its robust profitability metrics offset by its capital spending demands. Its difficult-to-reproduce assets contribute to a wide economic moat from Morningstar's Equity Research Group that supports its Business Risk score. However, many components within the Business Risk pillar reduce the overall score to moderate. Kansas City Southern has a relatively small size, as it is the smallest rail that we cover. We also account for the political risk relating to rail concessions granted to its Mexican operations (roughly 50% of 2017 revenue) through higher-than-average marks for its product and customer concentration and cyclicality of operations.

Kansas City Southern has monetized its competitive position into low teens returns on invested capital and an interest coverage ratio of nearly 11.0 times, boosting its Solvency Score. However, this score is reduced by a low quick ratio. We expect Kansas City Southern will increase operating cash flow, but its Cash Flow Cushion score is affected by its capital spending, which has historically averaged close to 25% of sales. The company faces a light maturity schedule over the next five years, with its only material obligation a $300 million bond due in 2020. Still, we expect management will grow its $140 million dividend with earnings and expect it to reward shareholders with repurchases along the way.

At this point, we are assigning Kansas City Southern a stable outlook, as we expect the company's credit profile to remain mostly unchanged. The continued risk regarding international trade remains front and center, as Mexico awaits its incoming president, but it is this very international exposure that Kansas City Southern navigated to its success today. That said, should the political situation worsen meaningfully such that it threatens KCS' competitive position, then we would expect a possible downgrade. We envision any actions could hurt the company's Business Risk score while reduced profitability would hurt its Solvency Score and Cash Flow Cushion. Alternatively, if management were to decide to curtail excess share repurchases and use its residual free cash flow to retire debt, then we could envision a possible upgrade.

Morningstar Credit Ratings Releases Updated Rating for Becton, Dickinson

Morningstar Credit Ratings, LLC, is affirming its credit rating on Becton, Dickinson and Co at BBB. This rating reflects its recent leverage-increasing acquisition of C.R. Bard. After that transaction, pro forma gross leverage rose to the mid-4s, and the company aims to reach gross leverage of less than 3 times within three years of the deal's closure. Considering this deleveraging plan, which includes a suspended share-repurchase program, we maintain a stable view of the firm's credit profile.

Our credit rating considers its recent acquisition of Bard, which closed in early fiscal 2018. This acquisition increased Becton Dickinson's leverage just three years after the leverage-increasing acquisition of CareFusion, which was completed in early 2015. Initially after acquiring CareFusion, debt stood at $13 billion, or gross leverage in the mid-4s by our estimates. After that, Becton Dickinson actively deleveraged by repaying debt and increasing profits; as of March 2017, total debt stood around $10 billion, or gross debt/EBITDA in the low 3s. However, shortly after that, it announced the Bard acquisition, which was completed in December 2017, and as of June 2018, gross debt stood at $22 billion, or pro forma gross leverage of 4.2 times. Although the firm plans to reduce leverage to below 3.0 times within a few years of this latest combination, the leverage-increasing acquisition has cut into its Cash Flow Cushion and Solvency Score pillars, which now stand at moderate to weak levels. Positively, we do not see major refinancing risks in our five-year forecast period, which informs its investment-grade status, in our opinion.

Becton Dickinson's Business Risk pillar is stronger than its leverage-sensitive pillars and is influenced by the essential nature of its medical technology and scale advantages. As the largest manufacturer of needles and syringes, its scale creates a barrier to entry for competitors in this price-sensitive part of the healthcare industry. The CareFusion acquisition primarily added an infusion pump business that competes in a virtual oligopoly within developed markets and has significant expansion opportunities in emerging markets. The Bard acquisition has added top-tier positions in vascular, surgical, urology, and oncology devices. Currently, Morningstar's Equity Research Group assigns the firm a narrow economic moat and medium uncertainty around cash flows. The firm's Business Risk pillar also benefits from its sizable and diverse operations, which enjoy low-cyclicality characteristics.

Our outlook is currently stable. However, we would consider a downgrade if Becton Dickinson faces significant difficulties integrating Bard or meeting its leverage goal in a timely fashion. If it eventually sustains leverage below 3 times, we could consider an upgrade, as its Cash Flow Cushion and Solvency Score pillars could improve significantly. The company appears unlikely to meet that goal within the next couple of years, though. Also, to consider an upgrade in the future, we would need to be convinced that the company is unlikely to pursue another transformative, leverage-increasing acquisition.

Morningstar Credit Ratings Releases Updated Ratings for Netflix

Morningstar Credit Ratings, LLC is affirming its BB- corporate credit rating of Netflix, Inc. and maintaining a stable outlook. Our credit rating reflects Netflix's moderate Solvency Score, offset by weak Business Risk and Cash Flow Cushion pillars. While revenue and profitability continue to improve as Netflix adds subscribers across the globe, its credit profile remains overshadowed by high external funding needs, high operating uncertainty, and negative free cash flow.

At mid-2018, Netflix reported 124.5 million paid subscribers worldwide, including 56 million in the U.S. Netflix's Business Risk is supported by its expanding global market penetration and its substantial database of viewer habits and preferences that inform its content investment. Netflix is the largest player in the video streaming market, accounting for about one third of downstream prime-time traffic in North America, according to data from Sandvine. Morningstar's Equity Research Group assigns a narrow economic moat.

Despite considerable expansion in profitability and core cash flow, Netflix's content investment continues to exceed its internal cash flow generation, which penalizes the company's Cash Flow Cushion and may keep pressure on the Solvency Score. Total debt has increased by $3.5 billion from a year ago to end the quarter at $8.3 billion, including an April issuance of $1.9 billion. Cash and investments ended the June quarter at $3.9 billion, up $1.7 billion from debt issuance proceeds. Net leverage ended the June quarter at 3.0 times EBITDA, compared with 3.8 times a year ago, helped by 106% growth in EBITDA over the period.

We calculate that Netflix's cash flow before net cash content investment was $7.6 billion over the most recent 12 months, an increase of 23% compared with a year ago. However, cash content investment was $9.2 billion during the period, driving a $1.6 billion cash flow deficit. Management's capital policy remains focused on investing in company growth rather than returning cash to shareholders. There is no share-repurchase authorization, nor does the company currently pay a dividend. We expect Netflix's financial health to remain constrained by free cash deficits and the highly capital-intensive nature of content procurement. We forecast content spending to continue to grow between 20% and 25% per year over the next few years, which we expect to keep pressure on credit metrics. However, we consider short-term liquidity adequate for current needs, and the debt maturity schedule remains long-dated, with the next material maturity ($500 million) due in 2021.

Our rating is driven by our content growth forecast and its potential impact on Cash Flow Cushion and Solvency. Our base forecast also assumes 7% average domestic subscriber growth and average international growth of 30% over the next five years, which we expect to drive revenue growth in the mid-20s. As Netflix continues to gain scale, particularly outside the U.S., we believe margins should also continue to improve, expanding toward 12% by 2022. We may consider an upgrade of the credit rating if operating performance continues to improve and free cash flow approaches a sustainable break-even. Conversely, we may downgrade our rating if operating conditions or credit metrics materially worsen relative to our forecast.

Morningstar Credit Ratings Releases Updated Ratings for Norfolk Southern

Morningstar Credit Ratings, LLC, is affirming our BBB+ credit rating on Norfolk Southern Corp. Our BBB+ issuer rating reflects Norfolk Southern's favorable Business Risk offset by its substantial reinvestment needs and shareholder-friendly policies. Although Norfolk Southern has boost profitability since our previous review, we view this emerging credit positive as being offset by its expanded share-repurchase activity funded via incremental borrowings. We assign the rail a stable outlook as we expect these countervailing forces will result in its credit profile remaining mostly unchanged over the coming years.

Norfolk Southern owns assets that are difficult to reproduce and have enabled it to earn a wide economic moat from Morningstar's Equity Research Group that supports its Business Risk. Coal is one of its largest revenue sources, but Norfolk services numerous customers across disparate industries, helping the customer concentration and cyclicality components of its Business Risk pillar. Norfolk has historically leveraged its competitive position into strong returns on invested capital and solid interest coverage ratios. Although the structural slump in its coal business has had a downward effect on its results, management has improved profitability across all measures since 2015 and has thus prevented a material weakening in its Solvency Score. The Solvency Score is also supported by its modest total liabilities/total assets ratio but is slightly constrained by a low quick ratio. We project that Norfolk Southern will generate $4.2 billion in annual average operating cash flow during our forecast period, but reinvest approximately $2.0 billion per year in the business. Norfolk has already repurchased $700 million through the first half of 2018 and commenced a $1.2 billion accelerated share-repurchase plan in August, which will push the 2018 total to $2.7 billion. Moreover, we expect the rail to increase its $700 million dividend with earnings. Norfolk also faces a meaningful debt maturity schedule. Combined, these expected outflows result in a weak Cash Flow Cushion score

We assign Norfolk a stable outlook. Over the last few years, Norfolk Southern has implemented meaningful profitability initiatives that have lowered its operating ratio. However, we anticipate that management will continue to funnel the additional cash flow via expanded shareholder disbursements such that leverage will remain around current levels. Our credit rating could move upward if management instead diverts the cost savings and its remaining free cash flow toward debt reduction, helping both the Solvency Score and Cash Flow Cushion pillars. Alternatively, we could revise our rating downward should management decide to increase leverage to further enhance shareholder value. In this case, we'd expect that the added leverage would have a negative effect on both the Solvency Score and Cash Flow Cushion.

Morningstar Credit Ratings Releases Updated Ratings for Canadian National Railway

Morningstar Credit Ratings, LLC, is affirming our A credit rating on Canadian National Railway Co. Our rating reflects the company's cost advantage versus other modes of transportation offset by substantial capital spending requirements, debt maturities, and shareholder-friendly policies. We are assigning the company a stable outlook, as we expect its credit profile will remain mostly unchanged over the next few years.

Canadian National owns assets that are difficult to replicate and have enabled it to garner a wide economic moat from Morningstar's Equity Research Group that supports our Business Risk score. Canadian National has historically been the most efficient rail operator in our coverage group, generating margins far superior to the rest of the industry, although the gap has shrunk considerably the last few years. Even still, Canadian National has translated this advantage into industry-leading returns on invested capital and double-digit interest coverage ratios. The railroad runs its business with modest leverage, and it has a slightly elevated total liabilities/total assets ratio. However, since Canadian National typically operates with minimal cash on its balance sheet—averaging below 2% of revenue over the last few years—it produces a low quick ratio, the biggest detractor to its otherwise strong Solvency Score. Canadian National generates robust operating cash flow, which we project will average CAD 7.0 billion per year over the next five years. However, like all rails, Canadian National will reinvest a substantial portion, around 20% of sales historically, in the business to maintain its network. Notably, the company is ramping up spending over the next few years to expand capacity, including its largest locomotive purchase since 2012. In total, we forecast capital spending will average CAD 3.1 billion per year over our forecast period. We anticipate that management will use the remaining cash flow to reward shareholders through repurchases (CAD 2 billion expected in 2018) and increasing its dividend with earnings. Additionally, the company faces average debt maturities of CAD 602 million per year. Together, these factors weigh on its Cash Flow Cushion.

We assign Canadian National a stable outlook, as we expect its credit profile to remain similar over the next few years. We forecast that rent-adjusted leverage will hover around 1.8 times during our forecast period and believe management will refinance its debt as it matures. Our rating could move upward if management were to permanently lower its rent-adjusted leverage and reduce its share repurchases. These moves would have beneficial effects on both our Solvency Score and Cash Flow Cushion. Conversely, our rating could come under pressure should management pursue and maintain permanently higher rent-adjusted leverage. These two factors would put downward pressure on our Solvency Score and likely result in a rating downgrade.

Morningstar Credit Ratings Releases Updated Ratings for Canadian Pacific Railway

Morningstar Credit Ratings, LLC, is affirming our BBB+ credit rating on Canadian Pacific Railway Ltd. Our rating reflects the company's favorable Business Risk offset by substantial capital expenditure requirements. Canadian Pacific remains on track to achieve its rent-adjusted leverage target by the end of 2018. Thereafter, we expect that the company will earmark its remaining free cash flow toward share repurchases. We are assigning the rail a stable outlook since we expect that leverage and its overall credit profile will remain similar over the next few years.

Canadian Pacific owns assets that are difficult to reproduce and have enabled it to earn a wide economic moat from Morningstar's Equity Research Group that supports our Business Risk score. The railroad services numerous customers across diverse end markets such as grain, automotive, forest products, and chemicals. We think the total composition of the company's portfolio helps the customer concentration and cyclicality components of the Business Risk pillar. Canadian Pacific is among the most profitable class I railroads after an impressive improvement in profitability over the years that has enabled the company to produce midteens returns on invested capital. However, the balance sheet includes residual scars from activist prodding in its recent past, and these affect its near-term total liabilities/total assets and interest coverage ratios. In total, these offsetting factors result in a moderate Solvency Score. We estimate that Canadian Pacific will generate CAD 3.5 billion in annual average operating cash flow but reinvest CAD 1.5 billion per year in the business. Although its debt maturity schedule is a manageable CAD 270 million due on average each year over the next five years, we expect the company will increase its CAD 340 million dividend with earnings and believe it will return additional cash to shareholders through repurchases. All told, this weighs on the Cash Flow Cushion score.

We are assigning Canadian Pacific a stable outlook. So far, Canadian Pacific has produced mixed results in 2018, as labor disruptions and increased fuel prices stymied profitability despite solid volume growth. Management should achieve its 2.0-2.5 times rent-adjusted leverage by the end of 2018, and although it will introduce a new share-repurchase plan soon, we think increased EBITDA growth should help leverage from increasing materially. That said, should management decide to further reduce debt and lower its leverage target, then we could envision a possible upgrade, as lower leverage would help both the Solvency and Cash Flow Cushion scores. Conversely, our rating could suffer a possible downgrade if Canadian Pacific were to operate with permanently higher rent-adjusted leverage than its current target of 2.0-2.5 times.

Morningstar Credit Ratings Releases Updated Ratings for JPMorgan Chase

Morningstar Credit Ratings, LLC is affirming JP Morgan's A credit rating, which reflects the company's strong operating results, robust capital base, and diverse business mix. Our outlook for the company remains stable.

Our assessment that JPMorgan exhibits low Business Risk reflects the company's geographic and business line diversification, large size, narrow economic moat (as assigned by Morningstar's Equity Research Group), and above-average management score. With over $2.6 trillion of assets at midyear, JPMorgan is the largest of the global U.S. banks. Although its operations are broad and often complex, over 56% of managed revenue during the year ending June came from operations that we consider to be lower risk, such as retail banking and asset management. The company organizes its operations into four operating segments: consumer and community banking; corporate and investment banking; commercial banking; and asset and wealth management. The domestically focused consumer and community banking segment, which includes retail and small-business banking, mortgage services, and credit card lending, generated about 44% of managed net revenue in the first six months of 2018. The corporate and investment banking segment includes advisory, underwriting, and trading functions and generated about 36% of net revenue. Commercial banking, which includes lending activities to medium and large clients, generated 8% of revenue, while wealth and asset management generated the remaining 12%. Although investment banking represents a relatively large and potentially volatile revenue source, many of the segment's business lines hold leading market share positions, including global investment banking fees, global debt and global equity underwriting, and loan syndication. Morningstar's Equity Research Group assigns JPMorgan a narrow economic moat because of cost advantages in its core banking operations and intangible assets in its investment banking and wealth management operations, factors that positively influence the company's Business Risk score.

JP Morgan's credit rating benefits from a strong Solvency Score supported by the company's solid funding, asset quality, and profitability. Deposits fund more than 150% of loans, placing JPMorgan in the top decile of global banks. Asset quality is in the top quartile of peers, with nonperforming loans representing 1.49% of loans. Although low interest rates have negatively affected results over the past decade, this was recently partially offset by the positive impact of a lower effective tax rate. Profits compare favorably with those of most global peers, with returns on equity over 10% post-tax cut. We expect profitability to increase over our forecast period as interest rates rise. Regulatory capital levels are modestly lower than those of global peers, with a fully phased common equity Tier 1 ratio of 12.0% as of June 30. Capital is stronger on an accounting basis, and JPMorgan's 8.1% Tier 1/total assets ratio is in the top third of peers.

JPMorgan generates a very strong score on our Stress Test. The company benefits from high starting capital levels and a diverse loan portfolio split between consumer loans, which represented 56% of loans as of June, and commercial loans, which represented 44%. By category, we consider JPMorgan's loans to represent either average or below-average credit risk. JPMorgan's Stress Test score also benefits from the company's strong operations, and we believe the company could more than offset credit losses through organic capital generation in a hypothetical two-year stress period.

Our stable outlook on JPMorgan implies that we are unlikely to change our rating within the next one to two years. Our rating assumes that the company maintains its above-average profitability during our forecast horizon, including a return on average assets around 1.0% and return on common equity comfortably above 10%. Our rating also assumes that the company maintains capital levels near current levels. If realized profits were to fall below our expectations, we could consider a negative outlook or a lower rating. Lower capital levels or lower levels of reserves relative to nonperforming assets could also lead to a lower Solvency Score and a lower rating. A riskier loan portfolio or lower underwriting standards could contribute to a lower Stress Test score and a lower credit rating. Alternatively, if JPMorgan were to sustain materially higher levels of capital or profitability, we could consider a positive outlook or rating increase.

Morningstar Credit Ratings Releases Updated Ratings for CSX

Morningstar Credit Ratings, LLC, is affirming our BBB+ credit rating on CSX Corp. CSX has delivered tremendous profitability improvements since our previous review, but these credit enhancements have been coupled with increased debt and the unveiling of a meaningful plan to return cash in short order to shareholders. We think the credit benefits of higher profitability are mostly offset by the proclivity to return cash to shareholders. Moreover, we believe that further cash distributions will be part and parcel with profitability gains such that leverage is unlikely to fall materially. As such, we are assigning the company a stable outlook.

Our BBB+ credit rating reflects CSX's favorable Business Risk, offset by elevated leverage, meaningful capital expenditure requirements, and generous shareholder rewards. CSX owns assets that are difficult to reproduce, and its formidable barriers to entry have helped it earn a wide economic moat from Morningstar's Equity Research Group that supports our Business Risk score. CSX services numerous customers across diverse end markets, bolstering the Business Risk pillar through the customer concentration and cyclicality components. CSX has historically leveraged its strong competitive position into low-double-digit returns on invested capital and high interest coverage, and its recent profitability gains have been remarkable. It has improved its operating ratio 490 basis points to a record-setting 58.6%. Better profitability improves its returns on invested capital and interest coverage ratio that underpins its strong Solvency Score. We project that CSX will translate this profitability into impressive average annual operating cash flow of $5.2 billion per year during our forecast period, but its Cash Flow Cushion score is constrained by its cash outlays. We forecast average annual capital spending of $1.8 billion per year, anticipate the annual dividend of $700 million will grow meaningfully as profitability improves, and expect at least $5 billion of share repurchases through the first quarter of 2019.

Nevertheless, we assign CSX a stable outlook. CSX has delivered impressive profitability gains with the implementation of precision railroading, but it recently raised $2 billion of additional debt to fund share repurchases, and we expect it will look to further reward shareholders. Thus, the strong profitability gains are mostly offset by the negative effects that higher leverage will have on its overall rating. Our rating could move upward if management were to reverse its course and permanently lower its rent-adjusted leverage while curtailing large, future share repurchases. These two actions would benefit both its Solvency and Cash Flow Cushion scores. That said, our rating could come under pressure if management were to further increase leverage in a way to enhance shareholder value. At the current rate, we think the prospects for higher profitability will mitigate the concern, but should the initial progress prove fleeting, then we could envision a downgrade. We expect that higher leverage combined with lower profitability could put downward pressure on our Solvency Score and Cash Flow Cushion.

Morningstar Credit Ratings Releases Updated Ratings for U.S. Bancorp

Morningstar Credit Ratings, LLC is affirming U.S. Bancorp's AA- credit rating, which reflects the firm's diverse loan portfolio, strong profitability, and wide economic moat as assigned by Morningstar's Equity Research Group. Our outlook remains stable.

Our assessment that U.S. Bancorp's Business Risk is minimal reflects the firm's strong funding, excellent management, and cost-efficient operations. Management demonstrates a disciplined approach to funding, credit, and operating costs, and consistently reports metrics well ahead of peers. For the quarter ended June 30, these included a 55% efficiency ratio, a 0.48% net charge-off ratio, and a 15.3% return on average common equity. Revenue is split between interest income, representing about 57% of revenue in the first half of the year, and fee-based sources, representing the remaining 43% of revenue.

The company also operates two highly scalable businesses that generate stable high returns with little capital employed: Wealth management and payment processing contributed 13% and 27% of revenue, respectively, in the first half of 2018. Traditional consumer banking represented 38%, while corporate and commercial banking contributed 17% of revenue during the period. Treasury and corporate support contributed an additional 5% of revenue. Morningstar's Equity Research Group assigns U.S. Bancorp a wide economic moat because of cost advantages stemming from its low-cost deposit base, excellent operating efficiency, and conservative underwriting, which provides additional support to our rating.

The company's moderate Solvency Score reflects its solid profitability, including a return on assets that is consistently in the top decile of global peers. Also contributing positively to the strong pillar score are the company's asset quality, loan-loss reserves, and deposit funding, which are well above the average within its peer set. These positives are partially offset by a common equity Tier 1 ratio of 9.1% as of June, which is at the bottom of its peer set.

U.S. Bancorp's credit rating continues to benefit from a very strong score on our Stress Test. The company benefits from the strong underwriting on its loan portfolio, which is about evenly split between consumer and commercial loans. By category, we consider most loans to represent either average or below-average credit risk. The Stress Test score also reflects our view that U.S. Bancorp will continue to internally generate significant capital in a downturn, and as a result it exits our hypothetical two-year stress period with strong capital ratios.

U.S. Bancorp's rating also reflects the company's very strong score in our market-based Distance to Default pillar. In early September, the company's price/book ratio near 2.0 was in the top decile of peers, and its equity volatility was better than approximately 80% of peers.

Our stable outlook on U.S. Bancorp implies that we are unlikely to change our rating within the next one or two years. However, our rating could be negatively affected by lower preprovision income relative to average assets or by lower reserves relative to nonperforming and delinquent assets, which could lead to a lower Solvency Score. Higher levels of short-term wholesale funding could contribute to a lower Business Risk score. A riskier loan portfolio or lower underwriting standards could contribute to a lower Stress Test score and a lower credit rating. Conversely, higher capital levels could lead to a higher Solvency Score and a positive outlook or a higher rating.

Recent Notes Published by Credit Analysts

BP (A-, Stable) Issues Debt for General Corporate Purposes and Working Capital

Market News and Data

BP plc (A-, stable) is reportedly in the market Sept. 18 with an offering of 7- and 10-year senior unsecured notes. Proceeds from the offering will be used for general corporate purposes, including working capital for BP or other companies in the BP group and the repayment of existing borrowings.

For market comparisons, we reference integrated oil and gas peers ExxonMobil (AA+, stable) and Chevron (AA-, stable). As the world's largest refiner and one of the world's largest manufacturers of commodity and specialty chemicals, ExxonMobil is much larger than BP. Chevron is the second-largest oil company in the United States, conducting exploration, production, and refining operations worldwide. All of the bond data is sourced from pricing service Interactive Data.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:

- BP 3.588% notes due April 2027 at +81 basis points.
- Chevron 2.954% notes due May 2026 at +57 basis points.
- ExxonMobil 3.043% notes due March 2026 at +47 basis points.

For comparison to the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +104 basis points in the A- and +82 basis points in the A categories, respectively.

MCR Credit Risk Assessment

Our A- rating on BP reflects the company's large scale and geographically diversified upstream reserves and integrated operations. BP typically derives about 70% of total operating income from the upstream segment and 30% from downstream. In order of significance, Rosneft (Russia, 19.75% equity stake), the United States, Africa, and Trinidad and Tobago account for a significant percentage of total BP oil equivalent production. The company's large size and market share helps to offset a no-moat rating (as assigned by Morningstar's Equity Research Group) and end-market cyclicality, placing overall Business Risk near the middle of the spectrum.

Although operating income is mostly derived from upstream activities, BP's downstream operations often achieve higher margins during times of low energy prices, partially offsetting the decline of production income. To pay for the more than $20 billion U.S. government settlement stemming from the 2010 Gulf of Mexico oil spill, BP undertook a broad asset-monetization program. BP has emerged from the incident with a smaller, more focused business footprint and revamped companywide safety policies and procedures that have resulted in, thus far, an improved safety record. With $22.2 billion in cash and equivalents and estimated $7.4 billion available on bank facilities, BP has more than adequate liquidity relative to near-term debt maturities.

Regarding leverage, we estimate the ratio of total debt/trailing EBITDAX to decline from 2.2 times at year-end 2017 to less than 1 time by 2022. We forecast revenue to grow 8% per year and EBITDAX margins to expand to 16% in 2022 from about 13% in 2018 as the company benefits from a rebound in energy pricing and a lower cost structure. After capital expenditures, dividends, share repurchases, and divestments, we estimate net cash flow for BP in 2018 of $8 billion, steadily increasing thereafter.

Interpublic Group (BBB, Stable) Announces New Senior Notes to Fund Acxiom Acquisition
Market News and Data
The Interpublic Group of Companies, Inc. (BBB, stable) is in the market with new unsecured senior notes, including 10-year and 30-year maturities. According to a regulatory filing connected with the proposed offering, the company intends to use the proceeds to fund its pending $2.3 billion acquisition of Acxiom Marketing Solutions, which it expects to complete by calendar year-end 2018. The proposed senior notes complement a $500 million, 3-year term loan agreement that the company signed in July. The notes do not contain any contingencies in the event the acquisition is not approved by regulators in the United States and Germany.

We believe the most comparable peer to IPG is Omnicom Group Inc. (BBB+, stable). For additional reference, we have also included notes from similar-rated media issuers CBS Corp. (BBB, stable), Viacom Inc. (BBB, stable), and Discovery Inc. (BBB-, stable). According to pricing from Interactive Data as of Sept. 17, similar-maturity senior notes of Interpublic and Omnicom are indicated as follows:

- Interpublic's existing 4.20% notes due 2024 at 142 basis points.
- Omnicom's 3.65% notes due 2024 at +123 basis points

The following are notes in the 8- to 10-year maturity area from similar-rated media issuers:

- Omnicom's 3.6% notes due 2026 at +131 basis points.
- CBS's 3.38% notes due 2028 at +145 basis points.
- Viacom's 3.45% notes due 2026 at +147 basis points.
- Discovery Inc.'s 3.95% notes due 2028 at +159 basis points.

According to data from Morningstar, Inc., the BBB category of the Morningstar Corporate Index was +141 basis points as of Sept 17.

MCR Credit Risk Assessment
Interpublic reported total debt at June 30 of $2.0 billion supported by $493 million of cash and equivalents. The balance of cash has declined $168 million from a year ago, while debt has increased $217 million. We calculate that Interpublic's net debt ended the June quarter at 1.3 times EBITDA, or 2.8 times adjusted for operating leases based on a multiple of 8 times 2017 rental expense. Pro forma for the AMS acquisition, the company projects its net debt to increase to 2.6 times, based on combined EBITDA of $1.4 billion. Based on this, we estimate lease-adjusted leverage is likely to increase to 3.7 times. For comparison, higher-rated competitor Omnicom's lease-adjusted leverage was 2.1 times through the end of June.

In the most recent 12 months, Interpublic generated free cash flow of $329 million, a 54% decrease from the prior year due to higher working capital spending this year. Over the past year, Interpublic spent $60 million on acquisitions and contingent payments and $538 million via dividends or share repurchases, driving a funding deficit of $269 million for the period. In preparation for the acquisition, Interpublic's management has suspended its share-repurchase program to divert cash flow toward debt reduction.

We continue to view Interpublic's maturity schedule as manageable, and we expect free cash flow to cover financial obligations as they are due. As of June 30, the next scheduled maturity is $250 million of senior notes due in 2022. However, if the acquisition closes by year-end, we expect an additional $500 million of maturities in late 2021 from the acquisition-related term loan. Interpublic's short-term liquidity remains supported by an undrawn $1.5 billion revolving credit facility due October 2022. The credit facility also supports Interpublic's $1.5 billion commercial paper program, against which it reported $676 million outstanding at Sept. 30.

Despite higher leverage from the acquisition, we do not anticipate a material impact on our credit rating. Our BBB credit rating reflects Interpublic Group's persistent margin expansion and disciplined use of debt. Business Risk is supported by moderate uncertainty, competitive strength, and diversity, partially offset by high cyclicality of operating performance and Interpublic's smaller market share relative to its peers. The rating is also supported by moderate Cash Flow Cushion and Solvency pillars. As the fourth-largest global advertising firm, Interpublic's broad portfolio of services allow the company flexibility in serving its customers. Morningstar's Equity Research Group assigns the company a narrow moat rating, supported by high customer switching costs and a substantial base of creative talent and intangible assets.

Interpublic's debt is issued out of the parent holding company, which relies substantially on its disparate operating subsidiaries to produce sufficient free cash flow to cover its debt service and administrative expenses. The company relies heavily on acquisitions for growth, though these have normally been small takeovers of independent agencies. We believe the high concentration of the largest advertising conglomerates hinders the opportunities for transformative merger and acquisition activity among the largest players. The acquisition of AMS appears to add to Interpublic's position in digital marketing, data analytics, and data privacy as the company looks to expand its digital presence.

U.K. Regulators Plan Auction to Resolve Competition Between Comcast (BBB+, Negative) and Fox for Sky

MCR Credit Risk Assessment

The U.K. Takeover Panel has announced that it will conduct a three-round auction Sept. 22 to settle the competitive takeover of Sky Plc (not rated) between Comcast Corp. (BBB+, negative) and Twenty-First Century Fox (not rated). Comcast currently stands as the high bidder with a proposal of GBP 14.75 per Sky share. Fox's highest and best proposal so far is GBP 14.00 per Sky share. For comparison, Sky currently trades at GBP 15.82, indicating a market capitalization of $37 billion.

The auction procedure will consist of three rounds that will all be completed on Sept. 22. In the first round, the low bidder at commencement will have the opportunity to increase its bid. In round two, the high bidder will have an opportunity to increase its bid in response to the result of round one. For rounds one or two, if the active party does not increase its bid during its turn, then the auction will be terminated with the high bidder at that time prevailing. If both parties increase their bids in rounds one and two, the auction will proceed to a third round wherein both bidders will be allowed to increase their bids a final time. In advance of the auction, both bidders will be allowed to announce changes to their existing bids until 5 p.m. London time on Sept. 21. Results of the auction will be announced by the Takeover Panel sometime during the evening of Sept. 22.

The resolution of the Sky takeover would provide clarity to the closing process of the merger between Fox and Walt Disney Co. (A+/UR-), which hangs on whether Fox will be able to buy the 61% of Sky shares that it does not already own. We believe that if Comcast wins Saturday's auction, Fox would divest its Sky shares to Comcast and proceed with the sale of other assets, thereby reducing Disney's ultimate total purchase cost.

Morningstar Credit Ratings, LLC downgraded its corporate rating on Comcast to BBB+ on July 18. Our downgrade reflected Comcast's weaker stand-alone Business Risk and Distance to Default scores, offset by a stronger Solvency Score and stable Cash Flow Cushion. Though our current rating does not fully incorporate the potential impact of a Sky acquisition, the negative outlook recognizes that if the company succeeds in acquiring Sky, higher leverage and concomitantly weaker credit metrics over a prolonged period may further weaken the rating. At Comcast's current proposal, we calculate that it will need to raise $34.6 billion of cash to affect the purchase and would assume just under $9 billion of Sky debt, pushing net debt of the combined company to around 3.0 times pro forma EBITDA from 2.0 times at the end of June.

If Comcast is unsuccessful in acquiring Sky, we believe that event risk may remain elevated to the extent that management remains interested in pursuing alternative acquisitions. Comcast is the second-largest U.S. pay-TV provider behind AT&T with a very strong competitive position despite growing competition from nontraditional video platforms. Meanwhile, Sky is the largest pay-TV provider in the United Kingdom. If successful, we believe that Comcast's proposed acquisition of Sky would combine its U.S. pay-TV assets with the Sky's leading market positions in the U.K., Germany, and Italy and give it full access to Sky's large store of proprietary video content.

Market Data

Based on price data from Interactive Data as of Sept. 19, BBB+ rated Comcast's 3.15% notes due 2028 traded at +106 basis points over the nearest Treasury, 25 basis points wider relative to the level on Feb. 23, before Comcast's announcement of its original proposal for Sky. For comparison, A+/UR- rated Disney 2.95% notes due 2027 traded at +66 basis points, 12 basis points wider from Feb. 23. BBB rated CBS Corp.'s 3.38% notes due 2028 traded at +147 basis points, 12 basis points wider over the same period. Meanwhile, the BBB+ category of the Morningstar Corporate Bond Index, at +133 basis points on Sept. 19, is 14 basis points wider since Feb. 23.

Adobe Systems (AA-, Stable) Acquiring Marketo for $4.75 Billion; Credit Rating Unaffected
On Sept. 20, Adobe Systems Inc. (AA-, stable) announced an agreement to acquire business-to-business marketing automation provider Marketo for $4.75 billion. Adobe intends to fund the acquisition through a mix of existing cash and new debt. Notwithstanding higher anticipated leverage from the acquisition, we believe Adobe will remain solidly positioned in the AA- category. Accordingly, Morningstar Credit Ratings, LLC is not taking any rating action at this time. However, we may revise either the rating or the outlook in the future in the event of material adverse changes in the proposed merger terms, payment of termination penalties, or a material deterioration in the operating performance of Adobe or Marketo that we would deem to materially affect the pro forma credit strength of the combined companies. Adobe anticipates completing the acquisition during its fiscal fourth quarter ending on or around Nov 30.

We believe that the addition of Marketo to Adobe Experience Cloud will further expand Adobe's digital marketing portfolio, enhancing its leading position in the highly competitive industry. While Adobe is currently positioned as the most comprehensive marketing platform for business-to-consumer marketing, its lack of a sophisticated offering in customer relationship management in the past has been an obstacle to expanding its presence in the B2B marketing space. The acquisition of Marketo appears to provide Adobe capacity in marketing automation for enterprise with nearly 5,000 in-place enterprise customer relationships. We believe this should improve Adobe's ability to compete with other B2B marketing lead players, including Oracle Corp. (AA-, stable) and Salesforce (not rated).

Marketo was taken private in 2016 by Vista Equity Partners for $1.8 billion, which replaced existing management with a more experienced team. Based on information provided by management, Marketo generated pro forma revenue of $320 million in calendar 2017, expected growth of greater than 20% in 2018, and sequential improvement in operating margin, which we believe remains negative. Historically, Adobe has a strong record of successfully integrating acquisitions. If the proposed acquisition is successful, we assume that Marketo's revenue growth momentum will continue with operating margin becoming positive within three years. Including our Marketo projections, we forecast Adobe's EBITDA increasing from $3.2 billion in fiscal 2018 to $4.0 billion in fiscal 2019. Assuming the firm raises $2 billion of debt to fund this acquisition, we calculate that Adobe's total debt in fiscal 2019 will increase to 1.0 times pro forma 2019 EBITDA from 0.6 times for the trailing 12-month period ended Aug. 31. We continue to expect Adobe's rich cash position ($4.9 billion as of August) and strong free cash flow generation ($3.5 billion in the 12 months ended in August) to keep the firm's debt position manageable following this transaction.

Though acquisition spending increased sharply this year, Adobe's cash reserve and robust and consistent cash flow generation provide ample flexibility to absorb this level of activity without materially affecting its credit strength. Pro forma for this transaction, we believe Adobe's AA- rating will remain well supported by the firm's low Business Risk and strong Solvency Score. Including the $1.68 billion acquisition of e-commerce platform Magento, which closed in June, total acquisition spending for the year is on track to reach nearly $6.5 billion in fiscal 2018. However, Adobe has historically pursued a highly targeted and opportunistic acquisition strategy that has been well accommodated through internal capital resources. Over the next five years, Adobe faces only one debt maturity: $900 million due in fiscal 2020. Over this period, we project free cash flow to expand from $3.5 billion per year to over $6 billion. Adobe does not currently pay a dividend, though it has implemented an $8 billion share-repurchase program that runs through fiscal year-end 2021. Over the past 12 months, $1.9 billion of net repurchases have been made against this authorization.

Market Data

According to pricing data provided by Interactive Data as of Sept. 20, AA- rated Adobe Systems Inc.'s 3.25% notes due 2025 are indicated at a spread of +61 basis points, 1 basis point wider from their level on April 25, when we upgraded Adobe's credit rating. For comparison, Alphabet Inc.'s (AA, stable) 2.00% notes due 2026 are indicated at +41 basis points, 10 basis points tighter from April 25, while Oracle Corp.'s (AA-, stable) 3.25% notes due 2027 are indicated at +69 basis points, 10 basis points tighter from April 25. Over the same period, the AA category of the Morningstar Corporate Bond Index has tightened 5 basis points to +61 basis points.

Credit Contacts

Basic Materials
Sean Sexton, CFA
sean.sexton@morningstar.com
+1 312 348-3077

Consumer
Dave Sekera, CFA
david.sekera@morningstar.com
+1 312 696-6293

Consumer Defensive
Wesley Moultrie, CPA, CGMA
wesley.moultrie@morningstar.com
+1 312 384-5405

Consumer Cyclical
Wayne Stefurak, CFA
wayne.stefurak@morningstar.com
+1 312 696-6114

Energy
Andrew O'Conor
andrew.oconor@morningstar.com
+1 312 348-3021

Financials – Banks
Erin Davis
erin.davis@morningstar.com
+1 312 384-4810

Healthcare
Julie Utterback, CFA
julie.utterback@morningstar.com
+ 1 312 696-6278

Healthcare
Michael Zbinovec
michael.zbinovec@morningstar.com
+ 1 312 348-3136

Industrials
Rick Tauber, CFA, CPA
rick.tauber@morningstar.com
+1 312 384-5431

Industrials
Basili Alukos, CFA, CPA
basili.alukos@morningstar.com
+1 312 384-4984

REITs
Chris Wimmer, CFA
chris.wimmer@morningstar.com
+1 646 560-4585

REITs
Mike Magerman, CFA
mike.magerman@morningstar.com
+1 267 960-6022

Technology, Media, and Telecom
Michael Dimler, CFA
michael.dimler@morningstar.com
+1 312 696-6339

For More Information
Todd Serpico
+1 312 384-5488
todd.serpico@morningstar.com

MORNINGSTAR®

22 West Washington Street
Chicago, IL 60602 USA